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Supreme Court of the United States

OCTOBER TERM, 1943

No. 183

B. H. Inness Brown, David Paine, Ethelbert Warfield, et al.,

Petitioners,

vs.

John Gerdes and James D. Carpenter, Jr., Trustees of Reynolds Investing Co., Inc., Debtor,

Respondents.

ON WRIT OF CERTIORARI TO THE SUPREME COURT OF THE STATE OF NEW YORK

REPLY BRIEF OF PETITIONERS AND ANSWER TO BRIEF OF SECURITIES AND EXCHANGE COMMISSION *AMICUS CURIAE*

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PART ONE

IN REPLY TO TRUSTEES' BRIEF

The brief of the Trustees fails to meet the essential issue on this appeal and is wholly silent with respect to some of the basic arguments advanced in the Attorneys' brief. Moreover, the legal points raised by the Trustees, some of which have already been anticipated and refuted, either are based on alleged facts at variance with or unsupported by the record facts and findings below, or are utterly without merit.

I

Omissions and failure to meet issue in this case.

1. The Trustees do not dispute the proposition that a bankruptcy trustee coming into a state court is bound as any other litigant by the conditions imposed by the state; nor do they challenge the applicability of the recent pronouncements of this Court in the *Boteler* and *Palmer* cases* that trustees in bankruptcy enjoy no immunity from the operation of State laws.

2. They avoid the main issue (as does the brief of the Securities and Exchange Commission [see pp. 27 *et seq., infra*]) by addressing themselves to the general powers conferred upon the bankruptcy court by the Federal statute to supervise and fix administration costs and expenses and to award compensation or allowances to various individuals. Concession will readily be made that an attempt by the State Court to fix fees for services rendered within the bankruptcy court, such as opposing a claim filed in that court or aiding in the formulation of a plan of reorganization, or to grant an allowance from, or impress a lien upon, funds in the possession of the bankruptcy court would conflict with its exclusive jurisdiction. Yet that is not the problem before this Court, as the State Court here made no such attempt. The issue is whether a debtor in reorganization and then its trustees, who retain New York attorneys to commence and prosecute litigation in the New York court under specific order of the bankruptcy court, are subject to the New York Attorneys Lien Law; that is, does the State Court have power in accordance with a local statute to determine and enforce a lien upon a specific *res*, namely, a cause of action and proceeds thereof which the

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* *Boteler* v. *Ingels*, 308 U. S. 57, 58, and *Palmer* v. *Massachusetts*, 308 U. S. 79, 83-4 (Attorneys' main brief, pp. 16, 38, 39).

Trustees concede they were powerless to reduce to possession, except by suit in the State Court. Applied to actions in New York, the proposition urged by the Trustees would mean that in fulfilling its purpose to permit the bankruptcy court to control administrative costs Congress nullified the power of the State Court to determine the extent of the attorneys' lien under Section 475 of the Judiciary Law, while it left in full force and effect the State statutes which require a trustee in bankruptcy to give security for costs (N. Y. Civil Practice Act, Secs. 1522, 1528); to post an undertaking in the event he desires to attach property, or to obtain an injunction or order of arrest (C. P. A., Sec. 819); to pay the statutory fees for filing papers, sheriff's expenses and witnesses, as well as stenographic charges; or which make him liable to the imposition of additional costs up to $2,000 (C. P. A., Secs. 1512-14). Singly, these may appear to be negligible; together, however, they represent a substantial liability. The Trustees will undoubtedly concede that such statutory costs are fixed by the State and not by the bankruptcy court. It would appear, therefore, that there is no warrant for saying that Congress intended to annul any incident of a State Court litigation.

3. The Trustees make no effectual attempt to refute the cases cited and discussed in Point III of the Attorneys' brief that the provisions of Section 77B, not Chapter X, are applicable to Action No. 1, and that under that Section the bankruptcy court never had custody, possession or jurisdiction of *in personam* causes of action in favor of the debtor. Such causes of action were exclusively within the jurisdiction of the State Court, and it was only that part of the proceeds recoverable in such action less statutory fees and the Attorneys' charging lien—amounting under the New York law to a *pro tanto* assignment of the cause of action—that ever became subject to bankruptcy administration.

II

Statements in Trustees' brief outside, or at variance with, the record and findings below.

A. The alleged contract made by the Attorneys.

The principal argument advanced by the Trustees (Point I) is predicated upon their assertions as "fact" that the Attorneys entered into a contract, embodied in the plan of reorganization and the order of the Bankruptcy Court confirming it, that their fees would be fixed by the Bankruptcy Court which, in effect, constituted a waiver of their lien rights under Section 475 of the Judiciary Law; that they are bound by this contract, and the Court of Appeals so held. The same contention was urged by them in their effort to defeat certiorari on the ground that a question of local law, not of Federal law, was determined below. An examination of the record discloses that the allegation to this effect in the Trustees' answer (R. 27, 31) was specifically denied by the reply interposed by the Attorneys (R. 68). The trial court held that there was no such contract as alleged by the Trustees and decided the issue of jurisdiction on the basis of the applicable Federal statutory provisions. This finding of fact was affirmed by the unanimous decision of the Appellate Division. The Court of Appeals, which is restricted in its jurisdiction by the New York State Constitution to the review of questions of law, not of fact*; could not and did not disturb this finding.

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* "The jurisdiction of the court of appeals, except where the judgment is of death, or where the appellate division, on reversing or modifying a final judgment in an action or a final order in a special proceeding, makes new findings of fact and renders final judgment or a final order thereon, *shall be limited to the review of questions of law;* but the right to appeal shall not depend upon the amount involved." N. Y. Const., Art. 6, § 7; see *Matter of Plass v. The Central N. E. Railway Co.*, 226 N. Y. 449, 450 (1919); *People v. Bellows*, 281 N. Y. 67, 71 (1939).

From an examination of its opinion it is clear that its decision rested wholly upon the ground that the Constitution of the United States and the National Bankruptcy Act conferred an exclusive and non-delegable jurisdiction upon the Bankruptcy Court. The Trustees (Br. 13-14) quote certain language from the opinion of the Court of Appeals to make it appear that the Court determined "as a matter of fact" that the contract alleged by them was entered into. The quoted portion refers solely to that Court's construction of the Bankruptcy Act, which it held formed a part of the contract of the Attorneys. Obviously the determination that certain provisions of the Bankruptcy Act must be deemed to constitute the terms of an implied contract between the Attorneys and the Trustees is not a determination of a question of local law based upon an actual agreement, but rather the determination of a Federal question involving the construction of the Bankruptcy Act.

B. Substitution of the Attorneys.

The Trustees state (p. 6) that after the Attorneys' services were discontinued there was no substitution of the Attorneys and that the Trustees did not appear *pro se* in Action No. 1. This is contrary to the finding of Justice WALTER (R. 99). Neither the Appellate Division, which affirmed without opinion, nor the Court of Appeals, which reversed on the opinion of Judge FINCH, altered or purported to affect this finding in any respect. To test the assertion of the Trustees, one need only inquire how they were able to institute proceedings supplementary to execution for collection of the judgments or to take the legal steps to effectuate the settlement which they refer to, except by substituting themselves for the Attorneys. The fact that the Trustees refrained from formally moving for a substitution which they in effect sought does not alter the matter (R. 99).

C. Alleged abandonment of Globe action and settlement of Action No. 2.

The Trustees assert that the Globe action "has been abandoned; that neither the Attorneys nor the Trustees believe that there is a reasonable prospect of recovery". Further, that Action No. 2 "was settled in conjunction with the settlement of Action No. 1". No word in the record supports these statements. They were anticipated in our main brief (p. 4n). According to the record the Globe action was never abandoned; issue was joined and no steps taken whatever to withdraw or discontinue it at the time the lien proceedings were instituted. Action No. 2 was pending and at issue at the time the Attorneys were relieved of their duties. The finding of Justice WALTER is repeated (R. 98): "The other two actions have not yet been tried and are still pending undetermined."

D. Alleged excessiveness of the lien and unjustified reflection on the Supreme Court.

Although the Trustees unsuccessfully urged, both in the Appellate Division and the Court of Appeals, that the amount of the liens fixed by the Supreme Court were excessive, they attempt in this Court, through unsupported statements, to create the impression that the Supreme Court did not consider pertinent evidence brought to its attention and fixed the lien at an unconscionably high amount. This was done with the obvious purpose to influence this Court by the amounts of the liens fixed. It constitutes an unwarranted reflection upon the State Court. Under the circumstances it is essential to expose the misstatements and to summarize the record evidence upon which the liens were fixed.

FIRST: The following assertions in the Trustees' brief are without any record evidence to support them: that the judgments in Action No. 1 were settled for $150,000 against the principal defendants "because the defendants had no assets which would enable collection of a larger amount"

(p. 6); that the State Court fixed the lien at $100,000 "although the total collection by the estate on settlements of the action with all solvent defendants is approximately $190,000" (p. 10); that the Supreme Court, which fixed the lien, "knew that only $34,522 had been collected on account of the judgment in the New York action, and that the prospects were that not more than $150,000 would be collectible."

According to the record (R. 14-15), judgments in Action No. 1 were rendered against ten defendants in the following amounts:

A. Clarence K. Reynolds and William F. Woodward, jointly and severally	$1,180,185.53
B. William F. Woodward, individually	1,225.00
C. Jerome C. Brady, George H. Clayton, Vincent E. Ferretti and Calmur & Co., jointly and severally	1,310,109.13
D. Franklin Mayer	1,088,670.23
E. Prentice & Brady, partnership	40,886.18
F. William D. Boehn	11,538.98
G. George K. Hyslop	3,914.82

The settlement of $150,000 referred to by the Trustees, which took place after the Attorneys were relieved of their duties, related solely to defendants Clarence K. Reynolds and William F. Woodward. Not a word is mentioned in the record of any settlement with the other eight defendants or their solvency.

SECOND: The Trustees assert (Br. 25) that the State Court in fixing the lien "did not request the production" of certain pertinent papers relating to the above mentioned settlement with two of the defendants, thus insinuating that the Court did not properly consider evidence which the Trustees desired to introduce. It comes with bad grace from the Trustees to make this observation in view of the following facts: After the Attorneys com-

menced the New York lien proceedings by service of a petition upon the Trustees (R. 10 *et seq.*), it was arranged between the parties that the answer would be limited for the time being to the jurisdictional objection so that the Court could dispose of that issue first; and the answer interposed by the Trustees expressly alleges (R. 31) that they and the Attorneys "have agreed that only facts bearing on the jurisdiction of the Court be submitted at this time". The jurisdictional issue having been overruled, the State Court granted the Trustees ten days' time to answer on the merits (R. 109), that is, to March 6, 1942, which was extended to March 20, 1942 (R. 5), and set the matter down for hearing on March 31, 1942. On the day fixed for the hearing the Trustees appeared in court by Mr. Gerdes and, in spite of the fact that the order of the Bankruptcy Court authorized the lien proceedings in New York reserving merely the right in the Trustees to raise a jurisdictional question, which was done, they refused to proceed on the merits (R. 72, 73). The Court advised the Trustees, citing decisions of this Court, that they would not waive their right to review the jurisdictional question by going forward on the merits (R. 73, 110-111). At the conclusion of the first hearing the Court adjourned the case and requested the Attorneys to advise the Trustees of the adjournment "for the express purpose of giving them an opportunity to come in and present anything further that they desire—or present anything that they desire and, particularly to advise them that I would appreciate hearing from the Trustees their opinion as to the value of the services" (R. 85). The Trustees rejected this request and sent the letter (R. 93-4), referred to in their brief (p. 25), which concluded: "This letter is not intended as an appearance in the hearing before you, but as a friendly response—outside of the record—to your courteous request" (R. 94). Moreover, the reorganized corporation, the beneficiary of the Attorneys' services, condoned the action of the Trustees in refusing to participate

in the hearing and to furnish relevant evidence (R. 86-7, 91-3). Justice WALTER quite properly held that this letter delivered under such circumstances must be treated for judicial purposes as non-existent, stating (R. 9): "It is a strange notion that a litigant may deliberately refrain from attending a hearing before a court and yet convey allegedly pertinent ideas and information by means of a letter to the Judge."

THIRD: The Trustees' assertion that the amount of the lien as fixed was excessive and "represents more than 58% of the net recovery" (Br. 26) is absolutely false. The State Court's decision—reached after detailed proof was taken—was based upon the following essential facts:

1. The services of the Attorneys covered a period upwards of three years from 1938 to 1941, during which 8,814¼ hours of necessary time was devoted to Action No. 1, for which no compensation whatsoever had been received.

2. The Attorneys were highly successful in the litigation and obtained the substantial judgments referred to above. $187,000 has already been collected against only three of the ten defendants.

3. In the Virginia action, commenced by the Trustees against Richard S. Reynolds and his son, involving in part the identical transactions as those in Action No. 1, a stipulation was entered into whereby all of the evidence and proof adduced in the successful New York action, which consumed six weeks of trial, 4,800 pages of testimony and 448 exhibits, could be introduced into evidence in the Virginia Court. There was evidence that Richard S. Reynolds was receiving $100,000 a year as president of Reynolds Metals Company, and that his assets available for settlement of a lawsuit did not exceed $600,000 (R. 81).

Justice WALTER, before whom Action No. 1 was tried, and who was thoroughly conversant with the work, extent and value of the services rendered, stated that apart from the question of collectibility of judgments he would have no hesitation in fixing the lien in Action No. 1 at $145,000 or even a higher sum (R. 112). Nevertheless he did take into account the collectibility factor and substantially reduced the amount of the lien to $100,000 in Action No. 1 (R. 112, 113). It should be pointed out that in view of the fact that the Attorneys herein were not permitted to collect the judgments, but were relieved of their duties prior threto, Justice WALTER would have been justified in ignoring the collectibility of the judgments and computing the value of the services solely on the other factors. This, under the well-established rule that compensation for services of an attorney whose duties have been terminated must be fixed on a *quantum meruit* basis and cannot be made dependent on how successful some other attorney may be in collecting the judgment. *Martucci* v. *Brooklyn Children's Aid Society*, 284 N. Y. 408; *Matter of Tillman*, 259 N. Y. 133; *Matter of Krooks*, 257 N. Y. 329; *Matter of Weitling*, 266 N. Y. 184; *Matter of Montgomery*, 272 N. Y. 323.

The attempt of the Trustees to raise now the question of reasonableness by resort to incorrect statements outside the record will not impress this Court.

E. Alleged purpose and effect of stipulation and order of the Bankruptcy Court authorizing State lien proceedings.

Referring to the stipulation and order (R. 24-26) of Judge FAKE, authorizing the lien proceedings, the Trustees state (p. 6) that they withdrew their motion in the Bankruptcy Court to compel the Attorneys to turn over their papers so that the Trustees might request the State Court to recognize the exclusive jurisdiction of the Bankruptcy Court. That the Trustees should withdraw a proceeding already commenced in the Bankruptcy Court for the purpose of requesting a State Court, where no lien proceeding had as yet been commenced, to recognize the jurisdiction of

the Bankruptcy Court, is not only a transparent pretext but is contrary to the letter and purpose of the stipulation and order. A most casual examination of that document will demonstrate this (R. 24-6). This stipulation and order specifically directed the institution of the lien proceedings in the State Court with the permissive right in the Trustees, not a mandatory obligation imposed by the Bankruptcy Court, to raise a jurisdictional objection. Justice WALTER, properly construing this order, stated that the Bankruptcy Court "thus in effect authorized this proceeding subject to the trustees' claim of lack of jurisdiction" (R. 99).

It should be noted further that the Attorneys were "ordered" to institute the New York lien proceedings and not "permitted" as the Trustees state (Br. 7).

To say that this stipulation and order was simply an attempt to obtain from the State Court, as comity, a recognition of the exclusive jurisdiction of the Bankruptcy Court is absurd.

F. Alleged error in the record.

The Trustees' assertion (p. 9) that the opinion certified by the Court of Appeals is erroneous in stating that the appeal was upon constitutional grounds is groundless. The record plainly shows (R. 117), and the Trustees concede (Br. 9), that they appealed on constitutional grounds. This Court will not question the authenticity of the opinion so certified in the record merely because in the advance sheets the State reporter erroneously failed to state that the appeal was on constitutional grounds as well as by permission. Furthermore, the opinion of the Court of Appeals clearly shows that the Federal questions were the sole and decisive factors upon which the decision of that Court rested.

III

Answering the Trustees' legal contentions.

A

No contract arises from the plan of reorganization.

The first three points of the Trustees' brief are all predicated upon assumptions of fact contrary to the record and findings below.

Justice WALTER found, (a) that there is nothing in the plan, promulgated one and a half years after Action No. 1 was instituted and consummated two years thereafter, purporting to impair or destroy the lien rights of the Attorneys which attached at the commencement of the action, and (b) that the Attorneys were never parties to the plan of reorganization or the order confirming it. Such findings were affirmed by the Appellate Division and were not disturbed by the Court of Appeals, which based its decision on its construction of the Bankruptcy Act. The Trustees' legal arguments, therefore, are without basis of fact.

The Trustees, in their brief (pp. 12-13), seek to have this Court pass upon this factual issue and refer to two provisions in the plan (R. 52) which they contend embody the alleged contract by the Attorneys to waive their Attorneys' lien under Section 475: first, the provision that the Trustees shall retain continuing jurisdiction of the New York claims and shall continue to prosecute them, and that the bankruptcy court will fix reasonable compensation of the Trustees and their attorneys or counsel; and second, the provision which the Trustees have incorrectly quoted, reading as follows: "If the value of the portfolio of the Company shall, at any time prior to a complete and final adjudication on the merits of all of the claims reserved to the Trustees, be $300,000 or less, the assets of the Company shall not be further depleted by purchases or redemptions of debentures or shares of preferred stock without order of the Court after a hearing upon notice to the Trustees."

The first of these provisions has been referred to in our main brief (p. 47). The Trustees admit (p. 12n) that these terms of the plan are required by the Bankruptcy Act; and in fact the plan merely incorporates such provisions and goes no further. Obviously, the provisions of Chapter X providing that the bankruptcy court may fix the compensation of attorneys for the trustees, just as Section 62(d), the correlative section applicable to straight bankruptcy, are concerned only with allowances paid from assets of the estate in the possession of the bankrupcty court. It is significant that in *Sherman* v. *Buckley* and *In re Prudence Company*, discussed in our main brief (pp. 18-23), the Circuit Court of Appeals did not imply from such provisions an agreement of waiver by the Attorneys of their rights under Section 475.

As to the second provision in the plan referred to by the Trustees: Since the prosecution of the pending claims by the Debtor was vested in the Trustees under the Bankruptcy Act (Sec. 216 [13]) and the plan of reorganization, this provision constituted an obligation by the reorganized company to the Trustees not to exhaust its assets below a certain amount, so that the Trustees would be in a position effectually to prosecute all pending claims and to pay the expenses in connection therewith. It will be observed that the plan of reorganization contemplated a liquidation program, and this provision was inserted merely to insure that the Trustees would not be deprived of the necessary means to press the claims. This provision cannot be construed as a waiver by the Attorneys of their lien rights upon the New York actions.

The Discharge of the Attorneys Terminated Any Alleged Agreement Had There Been One

In addition to our contention that there never was an agreement as alleged by the Trustees, and that the Attorneys were not parties to the order confirming the plan, there is a third answer to the Trustees' contention given

by Justice WALTER; namely, that "if there be any ground for saying that any act by petitioners [Attorneys] constituted an implied agreement by them to look to the bankruptcy court for an allowance for their services in the actions in this court, as distinguished from an allowance for services rendered in the bankruptcy proceeding itself, such implied agreement was cancelled and terminated when the Trustees discharged them" (R. 109).*

In order to avoid the finding of fact that the Attorneys were discharged, the Trustees assert in their brief (pp. 15-16) that the Attorneys' contract was not abrogated by a wrongful discharge, and that the Court of Appeals held that the Attorneys had been permitted fully to perform the services for which they had been employed. The statement that there was no *wrongful* discharge is misleading, as no claim is made that the discharge was "wrongful". No one disputes that a client can discharge his attorney at any time for good reason, or as here, for no reason (see *Matter of Krooks*, 257 N. Y. 329, 331). The claim is, however, that the discharge terminated any agreement that may have existed and gave the Attorneys the immediate right to have their liens fixed under Section 475.

The assertion that the Attorneys were permitted to complete their services necessarily invites the inquiry as to what were the terms of the Attorneys' retainer. There was no express agreement setting forth the duration of their tenure. The only agreement alleged in the petition (R. 12) and found by the lower court (R. 98) arises from the order authorizing the Debtor and its Trustees to institute suits and to retain the Attorneys to act as their counsel. When attorneys are retained for a party bringing suit, it is implied that the attorneys will prosecute the action to judgment, and equally important, that they will take the necessary steps to collect the judgment, for that is the only purpose of the suit. *Larkin* v. *Frazier*, 224 N. Y. 421 (1918); *Ohlquist* v. *Nordstrom*, 143 Misc. 502, *aff'd* 238 N. Y. App. Div. 766, *aff'd* 262 N. Y. 696

* This point is referred to in our main brief (pp. 48-9).

(1933); 7 *Corpus Juris Secundum*, §96, p. 914; §116, pp. 947-8.

The implied agreement between the Attorneys and the Trustees is tersely summed up by Judge CHASE in the Court of Appeals in *Larkin* v. *Frazier, supra:*

> "Under the general authority conferred upon the defendant he was authorized to prosecute the action commenced by him for Clara C. Larkin to final judgment and to enforce collection thereof by the issuance of an execution thereon, to receive the avails of the execution from the sheriff and also to acknowledge satisfaction of the judgment at any time within the statutory period (citing cases). Likewise he would be authorized to institute proceedings supplemental to execution on the judgment. (*Ward* v. *Roy*, 69 N. Y. 96.) • • •"

In the instant case the Attorneys were notified (R. 22-3) that they were not to be permitted to collect the judgments in Action No. 1, but were to cease to function at the conclusion of the hearings before the Referee and that the Trustees themselves would handle the collection of the judgments. Moreover, the Attorneys were prevented from taking any further steps in connection with the *Globe* action and Action No. 2, pending untried. That the Attorneys, therefore, did not complete the services for which they were engaged, and were discharged is clear. Surely the Trustees and the Bankruptcy Court would have strenuously protested had the Attorneys on their own motion quit at that point and demanded payment for completed services.

The Trustees did not even deny or challenge the allegation in the petition of the Attorneys that they had been discharged (R. 20). Justice WALTER found that such was the fact, and this finding was unanimously affirmed by the Appellate Division. The Court of Appeals, whose jurisdiction as we have shown (*supra*, p. 4) is limited to the review solely of questions of law, could not and did not purport to alter this finding. The statement in the

opinion of the Court of Appeals, referred to by the Trustees (Br. 15), was not intended by that Court to reverse a finding made by both Courts below. It was merely an attempt by way of *obiter* to distinguish *Sherman* v. *Buckley*, which the dissenting judges of the Court of Appeals held placed jurisdiction in the State Court to fix the liens.

It is thus clear the Attorneys were bound by no contract constituting a waiver of their liens, and therefore that no question of *res judicata* or collateral attack of a Federal order is involved here.

On the foregoing analysis, *Stoll* v. *Gottlieb*, 305 U. S. 165, cited by the Trustees (p. 19) for the proposition that the order of the Reorganization Court may not be attacked collaterally is beside the point.

By tearing from its context one sentence in *Matter of Heinscheimer*, 214 N. Y. 361, the Trustees (Br. 16-17) urge that the charging lien under Section 475 of the Judiciary Law does not arise unless it was understood that the Attorneys were to share in the fruits of the recovery. The law is definitely to the contrary. The lien applies in all cases unless there is an express agreement of waiver, and the Courts will not make the assertion of the lien dependent upon any alleged claim that the Attorneys have other adequate protection. The Court of Appeals, in construing Section 475 specifically stated in *Robinson* v. *Rogers*, 237 N. Y. 467, 472, that

> "The statute has provided a lien in all cases and not merely where the client fails to provide some other form of security or protection, and the courts cannot themselves substitute another form of protection for that provided in the statute."

Nor is the *Heinscheimer* case inconsistent with the rule thus expressed. There the Court of Appeals actually enforced the charging lien to the extent of the value of the services rendered in connection with the particular action;

and as to other services performed under a general retainer unrelated to litigation, it properly held that no charging lien under the statute attached.

The Trustees have made the gratuitous and unsupported assertion (p. 9) that whether the Attorneys "have a lien for their services is not a matter of great importance to them in this case", and that they are amply protected without such lien. Suffice it to say that the Attorneys instituted the lien proceedings not as a futile gesture but because they deemed it essential that they have the protection granted them under Section 475; and any alleged security suggested by the Trustees cannot deprive them of a lien which the Court of Appeals has unequivocally held applies "in all cases".

B

The provisions of the Bankruptcy Act do not preclude the assertion and enforcement by the Attorneys of their liens under Section 475 of the Judiciary Law.

We have shown in considerable detail (Main Br. Point IV) that none of the applicable provisions of the Bankruptcy Act, examined in the light of their legislative history and judicial construction, reveals a congressional intent to preclude the state court from fixing liens upon causes of action prosecuted there by the direction of the bankruptcy court.

It will be seen that both the statutes and cases cited by the Trustees to support the contrary position are irrelevant. Not one of them involves the question of the right of an attorney to have the state court fix his lien upon suits prosecuted by him in that court with the authority of the bankruptcy court. They relate to applications for allowances made in the bankruptcy court out of funds in its possession or to services rendered in that court in the administration of the estate. Thus, in *Watkins* v. *Sedberry*, 261 U. S. 571; *In re Evans*, 117 Fed. 574; *In re McKenna*,

137 Fed. 611; *In re J. M. Fiske*, 209 Fed. 982; *In re Cheney*, 300 Fed. 465; *In re Levinson*, 19 F. (2d) 253, and *Watters* v. *Hamilton Gas Co.*, 29 F. Supp. 436, cited by the Trustees (pp. 22, 24-5), the Attorneys completed their services, collected funds for the estate and then applied to the bankruptcy court for compensation. The issue of State liens was not presented.

In referring to *Page* v. *Rogers*, 211 U. S. 575, the Trustees (p. 22) purported to paraphrase and quote this Court as holding

> "that 'the proper place to raise' the question as to the amount to be paid to the attorney for a bankruptcy trustee for services in a separate equity action was 'in the Bankruptcy Court' and not in the equity court."

This is a strange perversion of the opinion. The services were not rendered in a separate equity court, but, as this Court expressly stated, "this suit was brought in the bankruptcy Court itself" (p. 581). The decision, therefore, quite properly held that the fee should be fixed by the bankruptcy court where the suit was brought.

There is no magic in the language quoted from *In re Stemper*, 222 Fed. 690, referred to by the Trustees (p. 23) to the effect that an attorney for a bankrupt trustee may not acquire uncontrolled rights in the bankrupt's assets. The quotation becomes understandable when read in the light of the fact that the attorney was claiming a lien by virtue of an agreement with the trustee and not a state statute. Moreover, in this very quotation the rule is stated to apply to compensation for services which the Attorney "claims shall be paid out of the trust estate."

Fanning v. *Poe*, 76 F. (2d) 707, cited by the Trustees (pp. 20-21) as an authority "on all fours" is distinguishable on a number of grounds. There, an attempt was made by an attorney for a Georgia state court receiver to have the bankruptcy court in another jurisdiction fix and determine his lien under the Georgia law on claims of the receiver prosecuted in the bankruptcy court. In the first

place, the bankruptcy court is one of limited jurisdiction, having statutory authority concerned with the administration of a bankrupt estate. There is no provision in the Bankruptcy Act for the creation of attorneys' liens and the enforcement and determination thereof in the bankruptcy court. In the case at bar, on the other hand, Section 475 of the Judiciary Law creates attorneys' liens and provides for the enforcement thereof in the Court in which the action was instituted. In the second place, in the *Fanning* case, the Court expressly pointed out that no consent was obtained from the receivership court to institute the lien proceedings in the bankruptcy court; whereas, in the instant case, the lien proceedings in New York were expressly directed by order of the Bankruptcy Court. Finally, the *Fanning* decision was rendered by the Fifth Circuit prior to the *Sherman, Cup Craft* and *Ohio Oil* decisions handed down by the Second and Eighth Circuit Courts. Insofar as it may be said to contain any contrary dictum, it is not entitled to any weight in view of the later holdings.

The Trustees (p. 21) purport to quote from Section 62-d of the Bankruptcy Act and then omit an important qualifying clause without indicating such omission. Their version is as follows:

> "or any other attorney, seeking compensation for services rendered by him in a proceeding, shall file with the court a petition setting forth the value and extent of services rendered, the amount requested and what allowances, if any, have theretofore been made to him."

Actually that portion of the section quoted reads as follows:

> "or any other attorney, seeking compensation for services rendered by him in a proceeding *under this Act or in connection with such proceeding,* shall file with the court a petition, etc." (Emphasis supplied.)

The phrase so opportunely omitted indicates clearly, as the Attorneys claim (Main Br., pp. 41-2) that Section 62 relates to allowances for services rendered within the bankruptcy court itself or from funds in its possession.

The other sections of the Bankruptcy Act cited by the Trustees (pp. 23-4) likewise apply to such cases and do not purport to affect State attorneys' liens upon causes of action and proceeds thereof within the jurisdiction of the State Court.

In order to illustrate their claim that the reorganization court should have exclusive jurisdiction, the Trustees present a biased and incorrect picture as to the method of the State Court in fixing the fee. This attempt based upon statements outside the record has been fully answered (*supra*, pp. 6 *et seq.*). Such attempt was hardly fair coming from Trustees who rejected the request of the State Court Justice that they furnish him with all pertinent information respecting the proposed fees and the status of the debtor without prejudice to their claim that the State Court was without jurisdiction (R. 72-3, 85-6, 91-3, 95, 110-11).

The Trustees attempt (Br., Point VIII) to distinguish *Sherman* v. *Buckley* and the other persuasive decisions. A number of the alleged distinctions have already been anticipated and refuted (Main Br., Points I and II; p. 21n).

The other claimed distinctions are without substance:

(a) The Trustees state (p. 48) that in the *Sherman* case there was a substitution of the attorneys, whereas in the instant case there was no substitution or application for substitution. We have shown (*supra*, p. 5) that this statement is contrary to the record facts and findings below.

(b) Likewise, the contention (p. 49) that the Attorneys were not discharged is at variance with the facts (*supra*, pp. 13-6).

(c) The Trustees further urge that the lien of the Attorneys in the *Sherman* case arose prior to bankruptcy and was perfected thereafter as expressly permitted by Section 67-b of the Bankruptcy Act; whereas the liens herein arose after the bankruptcy proceedings and do not come within the purview of that section. The *Sherman* case had nothing whatever to do with Section 67-b, and not a single reference is made to this provision either in the briefs or in the decision. Under Section 67 all liens against the property of a bankrupt obtained within four months prior to bankruptcy proceedings and at a date when insolvency existed are void, with the exception of the liens of creditors specifically enumerated in subdivision b of that section. The attorneys in the *Sherman* case commenced suit years prior to the bankruptcy proceedings and their lien under Section 475 of the Judiciary Law arose from the moment suit was instituted. Consequently, Section 67, relating to liens arising within the four-month period, has no application to the case.

C

The enforcement of the lien by the State Court violates no rule against securing or enforcing a lien upon assets of a debtor during reorganization.

The Trustees urge (Points V and VI) that the determination of the Attorneys' lien by the State Court contravened the rule that no lien "on assets of a debtor" can be secured during the pendency of a reorganization proceeding, and that no State Court, without the consent of the reorganization court, may enforce a lien against assets of the debtor during such proceedings.

There are three conclusive answers:

First: There is and can be no asset within the custody of the bankruptcy court until the causes of action are realized upon through suit in the State Court. (See *In re Borok*, 50 F. [2d] 75, 77 [C. C. A. 2] and *In re Worrall*, 79 F. [2d] 88, 90, 91 [C. C. A. 2].) Since, as we have

shown, the laws of New York have imposed as a condition of access to its courts that the attorney shall have a charging lien to be fixed by that Court—which in effect constitutes an equitable assignment *pro tanto* of the cause of action—it necessarily follows, as Justice WALTER pointed out (R. 106), that "it is only the part [of the cause of action] which so remained vested in the bankrupt client which ever became subject to administration in bankruptcy". This is in accord with the statement of Judge SWAN in *In re Prudence Company*, 96 F. (2d) 157, *cert. den.* 305 U. S. 616, that "Success having been achieved, they [the Trustees] can reap the benefit of the judgment, but they take it subject to the attorneys' charging lien".

It is thus apparent that reference by the Trustees to provisions in the Bankruptcy Act and to decisions relating to mortgage foreclosures and receiverships or other lien proceedings affecting real or personal property which admittedly come within the custody of the bankruptcy court have no bearing whatever upon causes of action in favor of the debtor.

SECOND: The provisions of the Bankruptcy Act referred to by the Trustees, prohibiting the obtaining or enforcing of liens against the property of the bankrupt or debtor, obviously refer to liens arising out of claims, contracts or proceedings against the bankrupt or debtor which antedated the bankruptcy. The cases cited by the Trustees (pp. 28, 29, 33) are instances of this nature. They do not purport to cover the situation at bar, where the liens were fixed for services rendered to the Debtor and the Trustees subsequent to the institution of the bankruptcy proceedings. Thus, in *Van Huffel* v. *Harkelrode*, 284 U. S. 225, the lien according to the opinion of Mr. Justice BRANDEIS was "for unpaid state taxes which had accrued prior to bankruptcy". Moreover, upon sale of the property the lien was transferred to the purchase price (p. 226). *New York* v. *Irving Trust Company*, 288 U. S. 329, likewise involved a State's claim for additional franchise taxes for the years 1919 to 1928 against a corporation which was adjudged a

bankrupt in March of 1929. *Isaacs* v. *Hobbs Tie & Timber*, 282 U. S. 734, involved a mortgage given as security for a note issued prior to the bankruptcy proceedings. In *Straton* v. *New*, 283 U. S. 318, the claim of the creditor arose prior to bankruptcy; his judgment having been obtained in April, 1927, and the voluntary petition in bankruptcy having been filed on October 11, 1928. Indeed, in the *Straton* case, this Court refused to enjoin the State proceedings to sell the real estate which had been commenced more than four months prior to the bankruptcy.

THIRD: The bald, unsupported statement of the Trustees (p. 28) that a lien cannot be secured against assets of a bankrupt or debtor during the pendency of bankruptcy or reorganization proceedings is flatly at variance with the decisions that a debtor and its trustees coming into a State Court are subject to State lien laws. An excellent example is *Boteler* v. *Ingels*, 308 U. S. 57. There the trustee in bankruptcy had been operating the debtor's trucking business. He claimed that he was not liable to pay penalties under the California Motor Vehicle Tax Law and that the vehicles were not subject to the statutory lien covering the tax and penalties thereon. Upon the trustee's petition the District Court ordered the License Commissioner to issue licenses, directed that the vehicles be sold ex lien and permitted California to file a claim for fees, without penalties, within thirty days, failing which the claim was to be barred. The Circuit Court of Appeals reversed, ordering in the alternative that the fees and penalties be paid or that the vehicles be disposed of subject to the lien of the State for unpaid taxes and penalties. This Court affirmed the order of the Circuit Court of Appeals and rejected the contention of the trustee that he was immune from the local tax laws.

The Trustees can draw no comfort from *In re Fonda, Johnstown & Gloversville Railroad Co.*, 126 F. (2d) 604, cited in their brief (p. 28). No question of the right to enforce a State lien arose. As a matter of fact, in repudi-

ating the trustee's claim that he was immune from the particular tax and in directing him to pay it, the Circuit Court cited the *Boteler* case and reiterated the rule that Trustees are subject to, not immune from, State law.

United States v. *Wood*, 290 Fed. 109, *aff'd* 263 U. S. 680, cited by the Trustees (p. 28), also was not concerned with the enforcement of local liens arising during reorganization proceedings. It involved an attempt of the creditor to enforce a claim against the bankrupt upon funds in the hands of the trustee in bankruptcy.

In sum, the contention of the Trustee that no lien can be secured against assets during the reorganization proceeding, if correct, would necessarily mean that trustees may carry on business or conduct suits in a State Court with entire disregard of all State lien laws. It can hardly be contended, in view of the *Boteler* and like authorities, that a reorganization trustee of a trucking company, who, subsequent to his appointment, delivers cars to be repaired or stored by a garageman, is immune from a local garageman's or artisan's lien. Nor a trustee of a building company from a mechanic's lien. An attorney's lien is equally valid.

D

The Bankruptcy Court conferred jurisdiction upon the State Court to fix the liens upon the New York causes of action through its direction that such actions be instituted in the State Court. Moreover, the Bankruptcy Court, under Section 77-b, never had jurisdiction of Action No. 1.

The Trustees (Br., Point VII) contend that the Bankruptcy Court never granted jurisdiction to the State Court to fix the liens, and further that it had no power to waive or delegate its jurisdiction to fix fees of its agents.

There are two bases, as we have shown in our main brief, for the jurisdiction of the State Court to fix the liens upon the causes of action:

(1) Assuming that the Bankruptcy Court initially had jurisdiction of the cause of action, it relinquished jurisdiction to the State Court over the cause of action and all incidents thereof, including the fixing and enforcement of the Attorneys' lien by authorizing the institution of suit there (Main Br., Point I).

(2) Under Section 77-b in effect when Action No. 1 was instituted, the bankruptcy court never had jurisdiction over such cause of action (see *In re Borok* and *In re Worrall, supra,* p. 21); such jurisdiction was vested solely and exclusively in the State Court, the only forum where the Trustees could enforce the claim (Main Br., Point III).

Entirely avoiding the second of these bases which, in our opinion, is irrefutable, the Trustees endeavor to challenge the validity of the first ground by asserting that while the Bankruptcy Court conferred upon the State Court power to determine the issues in the New York suits this did not carry with it jurisdiction to fix the liens, since a lien proceeding constitutes "a separate and independent proceeding". This is clearly untenable. It is well settled that a proceeding to fix an attorneys' lien upon a cause of action is substantively an incident of the main suit, not a separate and independent proceeding. Indeed, as Justice WALTER stated (R. 104):

> "a proceeding to fix the lien is so strictly ancillary to that suit that federal jurisdiction of such a proceeding exists even though there be no such diversity of citizenship between the parties to such proceeding as would support federal jurisdiction of the fixation proceeding apart from the court's jurisdiction over the client's suit—and that, too, even though no substitution of attorneys in the client's suit is asked (*Woodbury* v. *Jergens Co.*, 69 Fed. 2d 49; *Lawrence* v. *Commodore Nav. Corp'n, supra,* [27 F. supp. 139])."

Clearly, the substantive rights of an attorney to the enforcement of his lien under Section 475, as defined in the *Sherman* and other decisions discussed in our main

brief, are not dependent upon whether the procedural method of asserting the lien is by motion in the action or by special proceeding. *Peri* v. *New York Central R. R.*, 152 N. Y. 521, referred to by the Trustees (pp. 38-9), merely stated, as Justice WALTER pointed out (R. 101-2), that lien proceedings are separate proceedings "in a procedural sense". In fact, supplementary proceedings to collect a judgment recovered in an action are regarded under the New York law in a procedural sense as a separate proceeding requiring new process, etc., but it cannot be denied that it is substantively an incident of the main suit and has no independent existence.

The argument of the Trustees that the Federal Court has no power to waive or delegate its jurisdiction to fix fees is of no moment here. It applies only to cases such as *Wright* v. *City National Bank and Trust Co.*, 104 F. (2d) 285, cited by the Trustees (p. 40), which relate to allowances for services rendered within the confines of the bankruptcy court, or to cases such as *U. S. Fidelity and Guaranty Co.* v. *Bray*, 225 U. S. 205, referred to by the Trustees (p. 40), which is concerned with the distribution of assets in the custody of the bankruptcy court.

PART TWO

ANSWERING THE SECURITIES AND EXCHANGE COMMISSION, *AMICUS CURIAE*

All of the arguments advanced in the brief of the Securities and Exchange Commission are found in substance in the brief of the Trustees and have already been refuted.

It should be noted that the Securities and Exchange Commission, as the Trustees, has significantly left unanswered the rule that a trustee coming into a State Court is in the same position as any other litigant, and the decisions of this Court in *Boteler* v. *Ingels* and *Palmer* v. *Massachusetts,* that debtors and bankrupt trustees are not immune from the operation of state laws.

Also, the Commission, just as the Trustees, has not addressed itself to the issue at hand—the power of a State Court to determine and enforce a lien upon a judgment and proceeds thereof obtained in a suit prosecuted in its court with the authority of the Bankruptcy Court (see pp. 2-3, *supra*).

No force can be found in the assertion of the Commission (p. 14) that "Section 475 is not * * * a normal procedure by which attorneys obtain their compensation for conducting litigation". It is quite true that attorneys in the normal course of events do not face the necessity of availing themselves of the protection granted by Section 475. It should be emphasized, however, that the situation at bar does not fall within the category of the normal and ordinary course of events. The Attorneys here had carried on with success an important litigation on behalf of the Debtor and later its Trustees with the approval of the Bankruptcy Court; they handled the main action for a period of upwards of three years, during two and a half years of which they represented the present Trustees; they conducted a thorough and painstaking investigation of the

complicated facts and complex questions of law, an inkling of which can be gleaned from the Court's decision in Action No. 1 (reported in 28 N. Y. Supp. (2d) 622-667); they handled intermediate appeals to the Court of Appeals; they conducted the six-weeks trial of Action No. 1 and were successful in their claims against all the important defendants; they conducted hearings before the referee which resulted in very substantial judgments. When they had traveled this long course and were ready to reap the fruits of their efforts by entering judgments and collecting them, the Trustees, without any cause for discharge or even notice or opportunity to the Attorneys to be heard before any tribunal, terminated their services and demanded the turnover of all papers. That is certainly not the normal procedure between attorney and client. Accordingly, the Attorneys were advised to take the appropriate means, perhaps not normal in ordinary situations, but assuredly normal and necessary in the circumstances at bar, to protect themselves.

Nor does the Commission advance its argument by asserting (p. 15) that Section 475 is "narrower than the allowance provisions of the Bankruptcy Act", that "it cannot be used where the action involved does not result in a recovery"; and that "if attorneys appointed by a bankruptcy court are unsuccessful in a state court action to recover a money judgment * * * they have no alternative but to resort to the Bankruptcy Court for allowances". These statements are undoubtedly correct. The fact is, however, that fortunately in the case at bar, the Attorneys were successful in the State Court action in recovering a money judgment, and consequently come four-square within the scope, however narrow, of the protective provisions of this Section.

Argument I of the Commission

The attempt is made by reference to various provisions of the Bankruptcy Act to spell out a congressional intent to abrogate state attorneys' lien laws in all actions insti-

tuted by attorneys in a State Court on behalf of a debtor or bankruptcy trustee. Such attempt has been refuted in our main brief (Point IV) and *supra*, pages 17 *et seq.*

The Commission stresses the various safeguards contained in the Bankruptcy Act, such as the necessity of filing affidavits under Chapter X to insure the highest standards of fiduciary conduct on the part of the attorneys and to protect the assets of the estate. The clear inference sought to be created is that there are insufficient safeguards in a hearing before the State Court. This is an unjustified reflection upon the state processes. A lien proceeding in the State Court conforms with well accepted concepts of due process; it involves a judicial hearing, and ample notice and opportunity to be heard. The Trustees as the duly constituted representatives of the security holders are permitted to introduce any evidence whatever bearing upon the validity or extent of the lien. Judge WALTER in the instant case, who sat in the trial of Action No. 1 and therefore had first-hand knowledge of the services performed, not only welcomed such proof but repeatedly requested the Trustees to present anything that they desired bearing upon the merits of the lien. The State Court was also in a position to judge whether the Attorneys had complied with the highest standards of undivided loyalty. There is not a suggestion in the record that they had not. In fact, since it appears that the Attorneys represented the principal debenture and preferred stockholders' committee, they were required to file the affidavits under Sections 210 and 211 of Chapter X revealing the pertinent facts bearing upon their status. Finally, as we have shown in our main brief (p. 43) where a trustee sues in a state court, the defendant may plead and prove a counterclaim in the state court and the determination of such counterclaim is just as binding upon the Trustee and the estate as if it had been heard and allowed by a bankruptcy referee upon notice to all interested parties. The efficacy of such determination has never been questioned on the ground that the safeguards in the bankruptcy proceedings were more comprehensive or better than those in the state court.

Argument II of the Commission

This contention that the Bankruptcy Court has not surrendered its exclusive jurisdiction to determine fees, has already been fully answered.

The power of the State Court herein to fix the liens upon the New York actions and proceeds thereof, as distinguished from an alleged power to fix fees in general, stems (1) from the order of the Bankruptcy Court authorizing the institution of the suits in the State Court, (2) from the Federal Court's order and stipulation that the lien proceedings be forthwith instituted, and (3) from the provisions of Section 77B under which the State Court and not the bankruptcy court was the only tribunal that had jurisdiction of Action No. 1.*

Argument III of the Commission

The position advanced by the Commission that the attorneys waived their New York attorneys' liens, has been thoroughly refuted.

The import of the argument advanced is that in every instance that an attorney represents a trustee or debtor in a state court, he waives all local attorneys' lien rights. This is contrary to all of the adjudicated cases. Such drastic change requires a clear legislative expression:—none exists.

The Commission urges that the reorganization statutes formed part of the retainer of the Attorneys. We do not quarrel with this assertion. We claim, however, that the statutes do not purport to operate as a waiver by attorneys of their local liens or to confer immunity upon debtors and trustees from state laws applicable to all litigants.

* The Commission (p. 8) assumes that Chapter X is applicable to Action No. 1 by virtue of Section 276-c of that Chapter. As we have shown (Main Br. pp. 27-28) the provisions of Chapter X while applicable to prior proceedings in the reorganization court, do not apply to prior plenary actions instituted in another court. See *In re Standard Gas & Electric Company*, 119 F. (2d) 658, 663 (C. C. A. 3); *Tilton* v. *Model Taxi Corp.*, 113 F. (2d) 86, 88.

The order of the Court of Appeals should be reversed and the orders of the Supreme Court affirmed by the Appellate Division should be reinstated.

Respectfully submitted,

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